NECA NATIONAL EXCHANGE CARRIER ASSOCIATION INC

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Richard A. Askoff
Associate General Counsel

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MAY 26 1993

May 26, 1993

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: National Exchange Carrier Association, Inc.
Revisions to Tariff F.C.C. No. 5

Universal Service Fund and Lifeline Assistance Rates

CC Docket No. 93-123

Transmittal Nos. 518, 527, 530

Dear Ms. Searcy:

Enclosed herewith for filing with the Commission are the original and seven copies of the National Exchange Carrier Association, Inc.'s Direct Case in the above-captioned matter.

Please acknowledge receipt hereof by affixing a notation on the duplicate copy of this letter furnished herewith for such purposes and remitting same to bearer.

Very truly yours,

Richard A. Askoff

RAA/bas
Enclosures

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MAY 26 1993
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	CC Docket No. 93-123
National Exchange Carrier Association, Inc.	)	
	)	
Revisions to Tariff F.C.C. No. 5	)	Transmittal Nos. 518, 527, 530
	)	
Universal Service Fund and Lifeline Assistance Rates	)	

DIRECT CASE

National Exchange Carrier
Association, Inc.
100 South Jefferson Road
Whippany, New Jersey 07981

May 26, 1993

SUMMARY

The National Exchange Carrier Association, Inc. (NECA) submits this Direct Case in response to the Commission's Investigation Order in CC Docket No. 93-123. NECA herein demonstrates that its Universal Service Fund (USF) resizing methodology is reasonable and consistent with the Commission's rules.

NECA further demonstrates that the Commission should not require USF expense adjustment revisions to reflect changes in the National Average Cost Per Loop (NACPL) associated with USF data submission updates. However, if the Commission should require NECA to implement such adjustments, it should do so only on a prospective basis.

The Commission's rules permit exchange carriers (ECs) to submit changes to USF data on a quarterly basis. The rules further require NECA to recalculate the NACPL to reflect these quarterly updates for ECs submitting changes, but prohibits NECA from adjusting the NACPL for carriers not submitting updates. Consistent with the quarterly update rules, NECA resizes the USF to correct for the effects of errors and omissions in EC data, but does not adjust the NACPL for carriers that submit correct data.

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DIRECT CASE

The National Exchange Carrier Association, Inc. (NECA) submits its Direct Case in response to the Commission's Investigation Order in the above-captioned proceeding.[1] This Direct Case demonstrates that the methodology NECA uses to resize USF revenue requirements is reasonable and consistent with the Commission's rules.

I. BACKGROUND

A. NECA Transmittals Nos. 518, 527 and 530

NECA filed USF tariff revisions under Transmittal No. 518 on November 17, 1992, to be effective January 1, 1993. As required by Commission rules, the revised rates reflected January-June 1993 USF revenue requirements, as reported by exchange carriers (ECs) to

[1] National Exchange Carrier Association, Transmittal Nos. 518, 527, 530, Order Designating Issues for Investigation, CC Docket No. 93-123, (April 23, 1993) (Investigation Order).

NECA on July 31, 1992.[2] NECA's originally-proposed USF rate was 46.24 cents per presubscribed line (PSL) per month, an increase of approximately 18% over the then-current rate of 39.01 cents per PSL. Approximately 76% of this increase resulted from implementation of the last "step" of the eight-year USF transition, which began in 1986.

On December 28, 1992, at the request of Commission staff, NECA filed a revised USF rate under Transmittal No. 527 to reflect corrections made in response to the Commission's Responsible Accounting Officer Letter No. 21 (RAO 21).[3] The revised rate was 46.04 cents per PSL.

On December 31, 1992, at direction of the Common Carrier Bureau,[4] NECA filed Transmittal No. 530 which established a USF rate of $0.4404 per PSL per month to be effective January 1, 1993. This

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[2] Section 36.611 of the Commission's rules requires exchange carriers to provide USF cost data for the prior calendar year on June 30 of each year. NECA is required under section 36.613 of the rules to file USF data with the Commission on September 1 of each year. On June 9, 1992, the Commission granted in part NECA's request for a temporary change in the dates ECs are required to submit data to NECA, and the subsequent NECA filing dates. (National Exchange Carrier Association, Inc. Petition for Waiver of Sections 36.611(a) and 36.613(a) of the Commission's Rules, Memorandum Opinion and Order, 7 FCC Rcd 3863 (1992).) The waiver applies to the 1992 and 1993 periods. Under the waiver, ECs submitted 1991 calendar year data to NECA on July 31, 1992. As permitted under the waiver, NECA filed these data with the Commission on October 1, 1992.

[3] National Exchange Carrier Association, Tariff F.C.C. No. 5, Transmittal No. 527 (filed Dec. 28, 1992).

[4] December 30, 1992 Letter from Gregory Vogt, Chief Tariff Division, Common Carrier Bureau to Antonio Yanez, NECA Executive Director Tariff & Regulatory Matters (1600C1).

rate reflected revenue requirement increases attributable to implementation of the final USF transition step, but excluded increases in USF costs attributable to other factors. That rate went into effect as scheduled.

The Commission further directed NECA to make another tariff filing on January 29, 1993, extending the $.4404 per PSL per month rate into February 1993.[5] On February 5, 1993, the Bureau suspended for one day the rate proposed in Transmittal No. 527 (which reflected full USF revenue requirements and RAO 21 corrections), imposed an accounting order, and instituted an investigation into the lawfulness of the proposed rate.[6]

The Suspension Order expressed a concern that NECA's resizing and adjustment procedures appeared to inflate unreasonably the amount of USF payments.[7] In its subsequent Investigation Order, the Bureau explained that NECA has conducted bi-annual resizing of the USF since 1989 in order to "true-up" the USF revenue requirement. Current USF payouts to a company may change to

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[5] January 29, 1993 Letter from Gregory J. Vogt, Chief, Tariff Division, Common Carrier Bureau to Antonio Yanez, NECA Executive Director, Tariff & Regulatory Matters (1600C1). In response, NECA filed National Exchange Carrier Association, Tariff F.C.C. No. 5, Transmittal No. 535 on the same date.

[6] National Exchange Carrier Association, Transmittal Nos. 518, 527, 530, Order, 8 FCC Rcd 922 (1993) (Suspension Order).

[7] Suspension Order 8 FCC Rcd at 923.

reflect a retrospective revision to a particular company's data.

The Bureau noted that

> companies that revise their costs upward receive a larger USF payout. However, these revisions generally have not resulted in NECA correcting the national average loop

telephone service by high cost ECs through the assignment of what would otherwise be intrastate revenue requirements to the interstate jurisdiction.

Recovery of USF revenue requirements was initially accomplished through NECA Carrier Common Line rates. In accordance with section 69.603(c) of the Commission's rules, NECA distributed USF revenues to qualified telephone companies based on their expense adjustment amounts calculated pursuant to section 67.631 of the Commission's rules.[10]

Beginning April 1, 1989, the Commission no longer required mandatory participation in NECA's Common Line Pool.[11] Concurrently, a new recovery mechanism for the Universal Service and Lifeline Assistance Funds was introduced. The new mechanism required NECA to bill revenue requirements for both funds directly to interexchange carriers (IXCs) having more than .05 percent of the nationwide presubscribed lines.

Recognizing that individual company USF revenue requirements were subject to change, the Commission adopted rules for resizing

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[10] 47 C.F.R. § 67.631 was replaced in total by 47 C.F.R. § 36.631 beginning January 1, 1988.

[11] See generally MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Report and Order, 2 FCC Rcd 2953 (1987), aff'd on recon., 3 FCC Rcd 4543 (1988) (NTS Recovery Order), aff'd Public Service Comm'n of the Dist. of Columbia v. FCC, 897 F.2d 1168 (D.C. Cir. 1990).

the USF each year.[12] The Commission found that resizing would assure that adequate funds are available to provide authorized expense adjustment amounts to each qualifying exchange carrier, that the process would make the USF a more accurate reflection of actual costs,[13] and that the process would be consistent with the procedures for Lifeline Assistance.[14]

NECA calculates USF revenue requirements based on historical cost information provided by ECs pursuant to sections 36.611 and 36.612 of the Commission's rules. As required by section 36.622 of the rules, NECA calculates a National Average Unseparated Loop Cost per Working Loop (national average cost per loop or "NACPL") and a cost per loop for each study area. NECA then uses the resulting

Section 36.612 of the Commission's rules permits ECs to update information provided to NECA one or more times annually on a rolling year basis. Section 36.622 provides for recalculation of the NACPL to reflect these quarterly updates as follows:

> (a) National Average Unseparated Loop Cost per Working Loop. . . .
>
> (1) The National Average Unseparated Loop Cost per Working Loop shall be recalculated by the National Exchange Carrier Association to reflect the optional September, December, and March update filings.
>
> (2) Each new nationwide average shall be used in determining the additional interstate expense allocation <u>for companies which made filings</u> by the most recent filing date.
>
> (3) The calculation of a new national average to reflect the update filings <u>shall not affect</u> the amount of the additional interstate expense allocation for companies which did not make an update filing by the most recent filing date.[15]

As indicated by the underscored language, this rule requires NECA to recalculate the NACPL for companies submitting quarterly adjustments, and explicitly prohibits NECA from adjusting USF expense allocations for companies that do not submit such adjustments.

Consistent with the limitations imposed by section 36.622, NECA's semi-annual tariff filings include resizing adjustments to reflect quarterly updates. Differences in expense adjustment amounts are either added to or subtracted from the prospective six-month USF revenue requirement. NECA also resizes the USF to correct for errors and omissions discovered in EC USF data, and to

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[15] 47 C.F.R. § 36.622 (emphasis added).

account for shortfalls and overages that may occur for administrative reasons. These adjustments are discussed in more detail below.

II. ISSUES DESIGNATED FOR INVESTIGATION

A. Is The USF Rate Established in Transmittals 518, 527 and 530 Excessive Due To Resizing Procedures Employed by NECA?

(a) Provide the most current version of USF data, in the same detail as data submitted to the Industry Analysis Division in NECA's October 1, 1992 filing of 1991 study results, for each of the years 1989, 1990 and 1991.

Appendix 1, along with the enclosed diskettes, contain April 1993 (latest view) USF data for all study areas for data years 1989, 1990 and 1991. These reports include both current account level detail as submitted to the Industry Analysis Division in NECA's October 1, 1992 filing of 1991 study results, as reported by ECs, and calculations of each study area's unseparated revenue requirements, cost per loop, and expense adjustment.[16]

(b) List and describe the types of adjustments made to the USF revenue requirement, for example, quarterly, resizing and others.

NECA adjusts USF revenue requirements to reflect voluntary quarterly updates submitted to NECA pursuant to section 36.612 of the Commission's rules. NECA also adjusts USF revenue requirements each year to reflect changes to expense adjustment amounts due to

[16] Data for 1991 includes 2 study areas inadvertently omitted from the October 1, 1992 submission.

discovery of errors and omissions in EC USF data.[17] Additionally, NECA permits ECs that convert from average schedule to cost settlement status the option of providing historical cost data for use in determining eligibility for USF payments as of the date of conversion. ECs that are involved in mergers, acquisitions or asset sales are permitted to restate prior year data as though the transaction had been completed in the USF data year. The effects of these changes are included in resizing amounts in tariff updates.

Finally, NECA adjusts USF revenue requirements to reflect fund shortfalls and overages associated with various administrative factors, including realized uncollectible amounts,[18] interest income and expenses from NECA surplus and shortages of USF/LA revenues,[19] revenue shortfalls resulting from tariff deferrals,[20] differences between actual and projected NECA administrative expenses, and shortfalls or overrecoveries due to rate rounding.[21]

(c) Explain the conditions under which NECA recalculates the national average loop cost for purposes of resizing, separately describing those resulting in potential changes to all companies.

As noted above, section 36.622 of the Commission's rules requires NECA to recalculate the NACPL to reflect optional quarterly update filings, but explicitly states that the calculation of a new national average cost per loop to reflect update filings shall not affect the amount of additional interstate expense allocation for companies that do not make update filings.[22]

Consistent with the treatment of quarterly update adjustments under the rules, NECA adjusts the NACPL for companies having

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[19] As a result of timing differences between revenues billed and expense adjustment amounts paid, the USF fund experiences occasional shortfall or surplus conditions. When a shortfall occurs, NECA may borrow funds to meet its monthly expense adjustment commitments to ECs. When NECA receives more funds than are required to pay monthly expense adjustment amounts, it invests the surplus. Interest expense incurred is added to USF revenue requirements, and interest income earned from short term investments is subtracted from revenue requirements.

[20] See, e.g., National Exchange Carrier Association Revisions to Tariff F.C.C. No. 5, Universal Service and Lifeline Assistance Rates, Order, 7 FCC Rcd 429 (1991).

[21] The monthly USF rate per PSL is rounded to four decimal places. The shortfalls or surpluses resulting from this rounding are carried forward into future periods as a resizing adjustment.

[22] 47 C.F.R. 36.622(c).

significant data corrections, i.e., errors or omissions that result in an expense adjustment change that exceeds $1 million. NECA does not adjust the NACPL for companies that do not have significant data corrections.

> **(d) Provide all written internal procedures used to initiate new payouts due to resizing, for all companies based on a revision submitted by a single company.**

As discussed above, NECA does not initiate new payments for all companies based on a revision submitted by a single company. Appendix 2 contains the April 1993 issue of USF Internal Procedures and the May 1993 EC Data Collection Guidelines. These documents, The rule does not explicitly prohibit NECA from making broad adjustments to the NACPL following correction of errors and omissions by individual study areas. NECA believes, however, that the policy considerations that led the Commission to restrict quarterly update adjustments to carriers reporting quarterly update changes apply, as well, to situations involving potential changes due to errors and omissions.

By limiting the effects of quarterly update adjustments to carriers making such adjustments, the Commission assured non-adjusting carriers that their USF payments would remain stable. Stability of USF payments is important to ECs since the associated revenue requirements have been removed from state revenue requirements. It would be inconsistent to limit NACPL and expense adjustment updates solely to carriers making quarterly adjustments, yet require revision of NACPL and expense adjustment amounts for all companies when significant errors or omissions are discovered in a single study area's data. As described in (c) above, only quarterly updates and corrections for material errors and omissions result in the application of a revised NACPL for any EC payments. While the other resizing adjustments discussed in (b) above impact the size of the fund, they are not used in the NACPL calculation.

(f) Describe the legal and/or practical distinctions which justify different procedures between NECA's common line pool, where revisions to historical data result in adjusted payouts for many companies, and resizing of the USF fund.

As explained above in response to item (e), section 36.622 of the Commission's rules prohibits NECA from adjusting USF payments to individual study areas other than those associated with quarterly update filings. Consistent with the rule's treatment of quarterly update submissions, NECA also limits the effects of adjustments resulting from discovery of errors and omissions in historical data to ECs reporting such corrections. No such rules are applicable to adjustments to CL and TS pool distributions.

Beyond these differences in applicable rules, there are other fundamental differences in the operation of the USF fund and the CL and TS pools that justify different treatment of data adjustments. ECs that participate in NECA's CL and/or TS pools do so on a voluntary basis. In electing to participate, pool members place their interstate revenue requirements "at risk" in the NECA pools, with the understanding that pool earnings in a given rate period may or may not achieve authorized levels.[24]

A key advantage to participating in the NECA pools is that earnings risk is spread among a large number of small ECs. Nevertheless, ECs do expect that pool earnings will fluctuate based on actual operating experience of all pool participants. These fluctuations are reflected in NECA pool reports, which are

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[24] Under traditional rate of return regulation, NECA bases its CL and TS rates on projections of future cost and demand levels. The rates are "targeted" to earn at authorized levels. If NECA's cost and demand estimates are accurate, the pools will achieve the authorized rate of return. However, ECs must bear the risks associated with forecast error. For example, if actual costs exceed expectations, or if demand levels are lower than the forecast, the pools will not earn at authorized levels.

calculated on a monthly basis for the current month and each of the previous twenty-four months. Pooling ECs thus voluntarily accept the risk that adjustments made by one carrier in a given rate period will affect earnings of all participating carriers.

USF expense adjustment amounts, in contrast, are based on historical EC costs, not projections. Moreover, pursuant to the Commission's Part 36 rules, all qualifying ECs are required to offset intrastate costs and to assign them to the interstate jurisdiction to be recovered through USF charges. As noted above, section 36.622 of the Commission's Rules contemplates that USF payments to individual companies should not be affected when other carriers submit adjustments to USF data. This approach properly reflects the mandatory nature of USF cost recovery.

Through resizing procedures, NECA increases (or decreases) prospective USF revenue requirements to reflect prior period shortfalls and overages in the fund. This assures that ECs recover only the required amount of their USF expense adjustment (no more and no less). It also assures that IXCs pay no more or no less than the required amount, and that NECA, as administrator of the USF program, has adequate funds to make USF payments under the rules.

(g) **For the USF data years 1984 through 1991, list the total dollar amount if any, that the USF would have changed if the national average loop cost had been recalculated each time a company revised its data. Include amounts related only to resizing. List the dollar amounts for each year, by company.**

Appendix 3, along with the enclosed diskettes, display the impact of recalculating all companies' expense adjustments to reflect the effect of errors and omissions on the NACPL. The analysis is based on the April 1993 latest view of the national average cost per loop for data years 1984 through 1991. These data show that, in four of these eight years, USF payments would have increased if the national average cost per loop had been recalculated to reflect the effects of errors and omissions discovered after the filing.[25]

(h) Describe in detail any limits on the number of years NECA keeps books of account open for purposes of resizing. Describe whether NECA distinguishes among types of companies in determining which years' data should be used for resizing, and if so, the characteristics by which companies are treated differently.

NECA's procedures provide for a twenty-four month "window" in which exchange carriers may adjust USF data for expense adjustment purposes. This limitation is consistent with the twenty-four month payment adjustment period permitted under NECA's Agreement for the Distribution of Interstate Access Revenues. NECA and its member ECs have mutually agreed to establish these payment limitations in order to obtain finality within a reasonable period of time with

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[25] The attached analysis does not take into account the effects of Section 36.154(f) of the Commission's rules, which limits reductions in the subscriber plant factor (SPF) to 5 percent per year, after taking into account USF expense adjustments. Companies whose interstate assignment has been limited by the 5% rule would be required to revise their cost separations studies if their USF payments change and would be entitled to reflect a higher SPF as a result of the interaction of these rules. _See_ 47 C.F.R. § 36.154(f).

respect to financial reports. NECA does not distinguish among types of companies in determining which year's cost data should be used for resizing.[26]

NECA's Agreement for the Distribution of Interstate Access Revenues and its USF procedures are subject to FCC rules and orders. Thus, NECA could adjust pool or USF data outside the twenty-four month window if the Commission were to issue an order directing NECA to do so. Such adjustments would entail significant administrative effort and cost, however, since a number of NECA ECs would have to recalculate cost studies[27] and numerous non-standard adjustments to USF records would be required.

> **(i) Describe, both generally and in particular with respect to allocations to Category 4.13, how NECA detects errors made by reporting companies and what actions it takes to correct those errors. Describe the obligation NECA's procedures and the Commission's Rules create for companies to report to NECA accounting errors and corrections thereto, for companies that receive USF funds and those that do not. Explain any effect on the USF revenue requirement caused by such errors and their correction, as reflected in Transmittals 518 and 527.**

ECs annually submit USF data to NECA by June 30.[28] NECA

[26] Average schedule companies do not report cost data, therefore NECA does not include any average schedule data in its resizing calculation.

[27] See note 25 supra, describing requirement for affected ECs to recalculate prior cost separations studies.

[28] As noted above, NECA obtained a temporary waiver of the rules to permit ECs to submit data by July 31 in 1992 and 1993. See supra n. 2 and accompanying text. The 1992 USF Data Submission includes the USF data collection form used to collect detailed unseparated loop cost data and USF loop counts from the ECs. See

reviews these data for accuracy and conformance with FCC rules.[29] EC data that exhibits significant changes in investment, unseparated revenue requirement, loops, loop cost or expense adjustments are subjected to further scrutiny. ECs are then requested to provide explanations or corroborating information to substantiate data subject to review. NECA staff evaluates these responses and requests ECs to correct any data that may be in error.

Appendix 2 contains the procedures NECA follows to scrub data and correct errors. NECA reconciles USF data to financial records underlying exchange carrier cost studies. When errors are detected, corrections are made to USF data and expense adjustments are then recalculated for the affected study area.[30]

With respect to Category 4.13, investment amounts are reconciled to company cost studies or ARMIS data filed with the Commission. This assures that the categorization amounts reported

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National Exchange Carrier Association, Inc., 1992 Universal Service Fund Data Collection, filed October 1, 1992 (1992 USF Data Collection) at Tab 2.

[29] Each EC submitting data included a signed letter of certification attesting to the accuracy of the data. See 1992 USF Data Collection at Tab 2, page 9.

[30] NECA's procedures for reviewing USF data have also been described in detail in NECA's replies to petitions to reject and/or suspend recent LA/USF tariff filings. See National Exchange Carrier Association, Inc., Universal Service Fund and Lifeline Assistance Access Tariff Revisions, Transmittal No. 518, Reply at 6-7 (Errata filed December 15, 1992.) See also National Exchange Carrier Association, Inc., Universal Service Fund and Lifeline Assistance Access Tariff Revisions, Transmittal No. 475, Reply at 9-10 (filed December 2, 1991).

for USF purposes are consistent with the amounts used by the ECs in their interstate cost separations studies.

All ECs are subject to the Commission's accounting, separations, and access charge rules. These requirements are reflected in NECA's procedures and its Agreement for the Distribution of Interstate Access Revenues, which states that "[w]ith respect to all matters covered by [the Agreement], the Exchange Carrier and Association shall comply with all applicable FCC Orders, Rules and Regulations, as may be modified from time to time by the FCC."[31] Compliance with Commission rules is regarded as a continuing obligation. Each EC that submits data to NECA is required to sign a certification attesting to the accuracy of the data submitted.[32] Thus, if data is discovered to be in error (in the course of a NECA data review or independently by the EC), corrections must be made to the data submitted to NECA.[33]

Transmittals 518 and 527 included $14.3 M in resizing due to the correction of errors. This amount reflects correction of USF payments within NECA's 24-month window which includes data years 1989, 1990, and 1991.

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[31] NECA Agreement for the Distribution of Interstate Access Revenues, Section II. FCC rule compliance is emphasized in NECA's Cost and Average Schedule Pooling Procedures, USF Procedures, Cost Issues Manual, EC Data Requests and Data Checks, and in numerous other NECA documents.

[32] <u>See</u> 1992 USF Data Collection at Tab 2, p.9.

[33] A complete description of NECA's cost study review procedures may be found in NECA's Comments in CC Docket No. 93-6, Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes (filed April 14, 1993).

B. If The Bureau Requires NECA to Revise Its Procedures With Respect To The National Average Loop Cost As A Result Of This Investigation, Should This Ruling Be Applied Retroactively, And If So, How Far Back?

NECA believes that it has properly applied the Commission's rules in its USF tariff filings. Should the Commission determine otherwise, and require NECA to revise any of its procedures as a result of this investigation, the ruling should only be applied prospectively.[34]

USF expense adjustment amounts represent the interstate of the Commission's rules in 1992 that permits exchange carriers to delay submission of USF data from June 30 until July 31 of 1992 and 1993. As explained in NECA's waiver request, this additional time allows many NECA ECs the opportunity to complete interstate cost studies prior to submission of USF data to NECA. Further, enhanced "scrub" procedures will reduce the need for subsequent adjustments to USF data.[36] Resizing adjustments to USF should be lessened in future filings as a result of these changes.

III. CONCLUSION

The resizing procedures employed by NECA in calculating USF revenue requirements are reasonable and consistent with the Commission's rules. The Commission should not require adjustments to USF payments to reflect changes in the NACPL associated with

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Direct Case were served this 26th day of May, 1993, by mailing copies thereof by United States Mail, first class postage prepaid, to the persons listed.

By Susan Boylan
Susan Boylan

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